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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 720

ISADORE BLAU, a stockholder of Air-Way Industries, Inc., suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of Air-Way Industries, Inc.,

Petitioner,

against

EDWARD LAMB and EDWARD LAMB ENTERPRISES, INC.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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TABLE OF CONTENTS

	PAGE
I—The opinion by Court below is of grave and continuing concern to the general investors and management of public corporations and its broad implications are not limited solely to the particular facts of this case	1
Conclusion	6

TABLE OF CASES

Blau v. Lehman, 368 U. S. 403	5
Gratz v. Claughton (C. A. 2), 187 F. 2d 46	3
Greene v. Dietz (C. A. 2), 247 F. 2d 689	6
Heli-Coil Corp. v. Webster (C. A. 3), 352 F. 2d 156	3, 5
Petteys v. Blau (C. A. 8), decided October 19, 1966, and not yet reported. For full text of opinions see pp. 15-35 of Appendix to pending Petition for Certiorari in Blau v. Petteys, No. 755, filed in Supreme Court of the United States	4, 5, 6
Smolowe v. Delendo Corp. (C. A. 2), 136 F. 2d 231	5
Western Auto Supply Company v. Gamble-Skogmo, Inc. (C. A. 8), 348 F. 2d 736	3

STATUTES AND RULES

PAGE

Securities Exchange Act of 1934, as amended in 1964:

Sects. 12(g), 16(a), 16(b), 15 U.S.C.A., Sects. 78L(g), 78p(a), 78p(b) 5

Securities & Exchange Commission Rules:

Rule 16b-9, 31 Fed. Reg. 3391, 17 C.F.R., Sect. 240.16b-9, as amended 4

OTHER AUTHORITIES

Stock Exchange Practices, Hearings before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess., pt. 15 (1934) p. 6558 3

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I

The opinion by the Court below is of grave and continuing concern to the general investors and management of public corporations and its broad implications are not limited solely to the particular facts of this case.

The opinion of the Court below is predicated upon the rationale that every short-swing transaction must be closely examined on a case-by-case basis to determine whether it

is susceptible to the statutory abuse, and that the provisions of Section 16(b) of the Act will be applied to the transaction only after such a *subjective* "initial inquiry" has convinced the Court of that fact.

If permitted to stand, the opinion of the Court below would have serious implications far beyond the immediate issues here involved. For, not only would such a *subjective* test for the statutory application be required in the case of conversion transactions alone, but it would necessarily have to be applied as well in cases where the insider exercises an option to acquire his issuer's stock, in cases where he exchanges his issuer's shares for the securities of another corporation, in cases where he receives his issuer's shares in exchange for property, and in numerous similar situations. In fact, it is entirely conceivable that an insider might urge in the future that his ordinary *cash* purchases and sales of his issuer's securities within less than six months are not subject to the provisions of Section 16(b) of the Act because such transactions were not susceptible to the statutory abuse.

Wholly apart from the fact that such a *subjective* approach to the statutory application would place an unconscionable burden upon the issuer, or a stockholder suing on its behalf, to prove that the insider's transaction was susceptible to the statutory abuse (a burden which Congress never intended to impose), the execution of Section 16(b) would be bogged down by uncertainty and doubt because neither the issuer nor the insider would ever know with certainty whether the latter's short-swing transaction were susceptible to such statutory abuse or could be proven.

By expressly *eliminating* all considerations with respect to an insider's *subjective* purpose in effecting his short-swing transaction, Congress clearly evinced its intention that the provisions of Section 16(b) of the Act should be applied *automatically* and *without prior inquiry* as to the fairness of the particular transaction or its susceptibility

to the statutory evil, "even though it may cover instances where it (the evil) is *not* present."[1]

Such purposeful simplicity in the statutory application, and the "sure and speedy" remedy envisaged thereby, were intended to operate as one of its greatest deterrents in discouraging the insider from short-term speculation in his issuer's securities and his possible misuse of inside information in connection therewith. In order not to envelop the execution of the statute in a morass of factual and legal issues which would tend to vitiate the simplicity of its operation and destroy its effectiveness, the statutory application demanded "the necessity of having a general rule" to be applied *alike* in *all* cases.[2]

The respondents erroneously argue in their brief (pp. 7-8) that the decision by the Court below with respect to their conversion transactions allegedly "is of limited importance" because of the recently adopted Rule 16b-9 under which the Commission has purported to exempt from the statutory operation certain conversion transactions *meet-*

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[1] *Gratz* v. *Claughton* (C. A. 2), 187 F. 2d 46, at page 50.

[2] "You have to have a general rule. In particular transactions it might work a hardship, but those transactions that are a hardship represent the sacrifice to the necessity of having a general rule." *Stock Exchange Practices, Hearings before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess., pt. 15 (1934), p. 6558 (testimony of Corcoran).

In *Heli-Coil Corp.* v. *Webster* (C. A. 3), 352 F. 2d 156, the Court cited the above passage with approval, stating (at pp. 165-166) that the language of Section 16(b) indicates that it was the Congressional purpose "to lay down a hard and fast rule" for the statutory application with respect to all transactions alike and "that Section 16(b) does set up a 'rule of thumb' and was intended by Congress to do precisely that."

In *Western Auto Supply Company* v. *Gamble-Skogmo, Inc.* (C. A. 8), 348 F. 2d 736, the Court similarly expressed its approval for such a "general rule", stating (at p. 744): Section 16(b) must be construed so as to not dilute its vitality. We cannot have one rule for insiders with good intentions and another for those who would flagrantly abuse their trust. The burdens of the Act must fall on all violations with equal weight."

ing the specific conditions set forth in that rule, "as not comprehended within the purpose of" Section 16(b).[3]

We have heretofore shown, however, that the implications of the opinion below go far beyond the immediate issue with respect to the particular conversion transactions here involved, and that its rationale could be equally applicable to many other, and perhaps *all* other, transactions involving possible violations of Section 16(b).

Moreover, Rule 16b-9 does *not* purport to exempt *every* conversion transaction from the statutory operation. The provisions of the Rule, by its express language, only purport to exempt those *particular* conversion transactions which meet the *specific conditions* set forth therein. Furthermore, in view of the express language and legislative history of Section 16(b) clearly indicating the Congressional purpose *to include* conversion transactions *within* the statutory operation, the validity of the Rule itself is extremely doubtful on the ground that the Commission exceeded its authority in adopting it.[4]

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[3] The text of Rule 16b-9, 31 Fed. Reg. 3391 (1966), 17 C.F.R. Sect. 240.16b-9, as amended, is set forth in Respondents' Appendix to its brief at page 11. The Rule became effective February 17, 1966 and was not intended to be applied retroactively.

[4] See *Petteys* v. *Blau* (C. A. 8), decided October 19, 1966, not yet reported. A Petition for a writ of certiorari in that case is presently pending before the Supreme Court of the United States (*Blau* v. *Petteys*, No. 755). The full text of the majority and dissenting opinions is set forth at pp. 15-35 of the Appendix to the Petition on file with this Court in that case. The majority opinion, adhering to the rationale of the Second Circuit in *Blau* v. *Lamb*, held that the insiders' conversions of Preferred into common stock were not Section 16(b) "purchases" of the common shares. Although the majority stated (at p. 32) that "our decision is not based on the S.E.C. amended Rule 16b-9 dealing with conversions", Judge Blackmun, in his dissenting opinion, made the following observation (at p. 34) with respect to the Commission's power to adopt such Rule:

"* * * I am not entirely sure that Congress, by the subsection's final sentence (of Section 16b), meant to give the Commission

(Footnote continued on following page)

We parenthetically note that for a period of more than thirty years following the enactment of Section 16(b) the Commission had traditionally supported the view, based upon its interpretation of the legislative history and language of the statute, that an insider's voluntary conversion of his issuer's security *was indeed comprehended within the purpose of that statute.*[5] Significantly, although the recent amendments to the Securities Exchange Act of 1934 expressly *broadened* the applicability of Section 16(b) by including certain *unlisted* public corporations within its scope, neither such amended statutory language nor its legislative history indicates any Congressional intention to exempt a voluntary conversion transaction from the operation of Section 16(b).[6] While it is true that the Commission was granted the authority to exempt a transaction from the operation of Section 16(b) if it found that the transaction was "not comprehended within the purpose of" that statute, such "actually limited authority" requires "that its regulations be consistent with the expressed purpose of the statute."[7] Moreover, the Commis-

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(Footnote continued from preceding page)

the power so to legislate at will by abruptly changing the reach of the statute which it had regarded otherwise for over a generation, or that, if it did, such delegated authority is not vulnerable to attack, or that the announced new rule is consistent with the statute anyway. * * *."

[5] The Commission supported such view as *amicus curiae* in this very case in the Court below. It also supported such view as *amicus curiae* in *Heli Coil Corp.* v. *Webster* (C. A. 3, 1965), *supra*, and in *Petteys* v. *Blau* (C. A. 8, 1966), *supra*.

[6] Sects. 12(g), 16(a) and 16(b) of the Securities Exchange Act of 1934, as amended in 1964; 15 U.S.C.A., Sects. 78L(g), 78p(a) and 78p(b). In *Blau* v. *Lehman*, 368 U. S. 403, this Court stated (at p. 413): "Congress can and might amend Sect. 16(b) if the Commission would present to it the policy arguments it has to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made."

[7] *Smolowe* v. *Delendo Corp.* (C. A. 2), 136 F. 2d 231, 240.

sion's exercise of its authority in adopting such an exemptive Rule is always subject to judicial scrutiny "in order to ascertain whether the Rule was a proper exercise of the authority delegated to the Commission under the Act.'"[8]

The conflicting views and dissenting opinions between and within the various Circuit Courts of Appeals, as to whether the application of Section 16(b) of the Act requires an "objective" or a "subjective" test, has recently led Judge Blackmun to make the following remark in his dissenting opinion in *Petteys* v. *Blau* (C. A. 8, 1966), *supra*:[9]

> "Perhaps the Supreme Court one day soon will tell us how these somewhat conflicting approaches to Section 16(b) by the Courts of Appeals are to be resolved. * * *."

CONCLUSION

For the reasons stated above and in the petition for a Writ of Certiorari, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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[8] *Greene* v. *Dietz* (C. A. 2), 247 F. 2d 689, 692.

[9] See p. 35 of Appendix in petition for writ of certiorari (*Blau* v. *Petteys*, No. 755.)